Development of a national social tariff:
A paper by [redacted] on behalf of Portsmouth Water

1. Introduction

Defra and the Welsh Government asked CCWater to review financial support for water customers and recommend how to improve the support available. The CCWater report in 2020 recommended that water companies, Water UK and Ofwat work together to create a single social tariff scheme, with pooled funding from all water companies' customers.

This paper is a contribution to the debate on structure and funding of a social tariff. It considers alternative structures and funding, evaluates them against objectives for the tariffs, and suggests a way forward.

2. Criteria for assessing options

There are a number of criteria to be considered in developing the scheme:

- **Achieving the water poverty objective** – in terms of making bills affordable for households with water and sewerage bills more than 5% of their disposable income.
- **Encouraging water efficiency**, through continuing to provide a financial incentive to save water for those customers who are metered.
- **Simplicity for customer communication and administration** – this will keep costs down, encourage customer take-up, and help to ensure that the scheme is implemented in the same way by different companies.
- **Avoiding large increases in bills for customers funding the scheme –** particularly as there are other customers not qualifying who are likely to be struggling to pay.
- **Maintaining water company independence and incentives to be efficient** – pooled funding could conflict with this objective.

Work has been carried out on the scale of the problem and tariff options but there is no approach which will meet all objectives for scheme structure or for funding – there are trade-offs to be made.

3. Defining the number of customers in water poverty

Water UK has made a commitment to: "Make bills affordable as a minimum for all households with water and sewerage bills more than 5% of their disposable income by 2030"[1]. To achieve this, it is important to know how many customers fall into this category.

[1] Public interest commitment, Water UK, April 2019

In defining the number of people who are spending over 5% of their disposable income on water bills, "equivalised income" is used. Equivalised income is income adjusted for household size, to reflect that larger households need a higher income. However, it leads to a larger number of customers being recorded as paying more than 5% of their income than is actually the case, as illustrated below. In these examples, no household has a bill which is more than 5% of disposable income but for three of the four cases their bill is more than 5% of equivalised disposable income.

It is not clear-cut that use of equivalised incomes is appropriate, and Ofwat has previously used income figures which have not been equivalised. Although equivalising incomes is a valuable approach to assessing affordability for different households, it does not seem reasonable to define customers as paying more than 5% of their income on water bills when they are not doing so.

In addition, there appears to be an element of double-counting in using equivalised incomes. Larger households will tend to have higher water bills, so the use of the water bill as a percentage of income already makes some adjustment for household size. We feel that the problem is being overstated and propose that the use of equivalised disposable income should be reconsidered.

Overstating the problem - examples

Household	1 adult	2 adults	2 adults, 1 child	2 adults, 2 children
Disposable Income	£12,000	£12,000	£12,000	£12,000
Equivalised disposable income	£12,000	£8,000	£6,667	£5,714
Water and sewerage bill	£500	£500	£500	£500
Water and sewerage bill as a % of disposable income	4.2%	4.2%	4.2%	4.2%
Water and sewerage bill as a % of equivalised disposable income	4.2%	6.3%	7.5%	8.8%

4. The scale of the problem

Equivalised income is the basis on which recent work has been carried out, as this was recommended in a report for Water UK[2]. Using the equivalised disposable income basis, work by Frontier Economics for Water UK indicates that 9% of customers are spending more than 5% of their income on water bills. These customers would require an average bill reduction of nearly £200 for their bill to be no more than 5% of their income.

[2] Measuring water poverty using a bills to income metric, CEPA for Water UK, June 2020

Even with perfect targeting of the scheme, this would need other customers to pay about £20 each – split between water and sewerage this could mean £10, or 9%, for Portsmouth Water customers. Targeting would inevitably be imperfect, unless each bill was individually tailored to a customer's income, and this would mean a higher impact.

5. Defining eligibility

For a national scheme, with a large number of potentially eligible customers, it would be desirable to have simple criteria for eligibility. This would simplify administration and help to ensure consistent application across different companies. Eligibility based on means-tested benefits would be a simple basis. However, the work for Water UK estimated that 59% of households charged over 5% of equivalised disposable income are not claiming a means tested benefit.

Defining eligibility at the minimum wage level would also be relatively straightforward. However, the work for Water UK estimated that 39% of the households charged over 5% of equivalised income have non-benefits income above the level of the national minimum wage.

Ensuring that all customers with bills greater than 5% of disposable income are eligible would, therefore, require individual assessment of household size and income. It would be difficult to ensure that this would be applied consistently by all companies.

6. Structuring the tariff

A number of different options have been considered – all have some limitations. The table below sets out the characteristics of some of the options which have been considered.

	Fixed personalised cap at 5% of income	Standard discount from company tariff	National charging rates	National charging rates with varying discounts according to income
Effectiveness at addressing water poverty objective	Very high	Low	Moderate	High
Ease of administration	Requires income and household size assessment	Relatively simple	Relatively simple	Requires income and household size assessment
Retention of water efficiency incentives	Incentives removed	Incentives retained	Incentives retained	Incentives retained

	Fixed personalised cap at 5% of income	Standard discount from company tariff	National charging rates	National charging rates with varying discounts according to income
Impact on non-qualifying customers	High bill impact and potential fairness issues from large discounts	Lower bill impact	Dependent on standard rates = potential fairness issues from large discounts	Bill impact and fairness issues dependent on scale of discount = potential fairness issues

Another consideration is the potential impact on customers currently benefiting from social tariffs. Options considered in the work for Water UK would lead to an average increase of around £150 for those currently benefiting. Depending on the eligibility criteria, there may be some customers no longer eligible for social tariffs, who could face increases greater than this.

The implications of different options for social tariff structure also need to be considered at the water : wastewater level. National charging rates for water could result in very low discounts for Portsmouth Water customers, because of Portsmouth's low bills.

7. Funding the social tariff

The CCWater report considered options for funding the scheme, including government funding, each company funding the costs in its own area, and joint funding at an industry level. Recent work has assumed joint funding at an industry level.

Maintaining water company independence is an important consideration. Water bills differ between company areas because of differences in raw water quality and availability, environmental sensitivity, network density etc. There are advantages in continuing this approach, rather than sharing costs, in terms of ensuring that each company aims to be efficient and keep costs down in its own area. In terms of social tariffs, central funding could remove incentives to ensure that the scheme is administered correctly to ensure eligibility, e.g. in terms of checks on income and household size. Sharing of costs could, however, be considered necessary if it is essential to avoid an excessive burden on customers in any company area.

In order to preserve water company independence, we consider that there should not be a general pooling of funding, but that funding could be made available where a company can demonstrate that:

- The cost of social tariffs would be a clear excess burden, compared with faced by customers of other companies.
- It has taken appropriate steps to provide funding from increasing revenue, e.g. through:
  - Checking whether there are any properties currently classified as empty which should be billed.
  - Reducing levels of bad debt.
  - Collecting additional revenue from customers who may be most able to pay more, e.g. through a second homes levy, rather than from the customer base in general.

8. Conclusions on the options for social tariffs and their impact

Our conclusions from the above analysis are that:

- The potential impact on customers not benefiting from the social tariff, many of whom will be struggling to pay bills because of other pressures on their finances, could be too great. An increase of 10% or more to ensure that no customers would constrain ability to deliver on other priorities, such as resilience.
- It is not clear what the best structure is for social tariffs – all options have some drawbacks and there are trade-offs to be made.
- It is not clear what the criteria should be to qualify for the tariff.
- We are not convinced that there should be pooled funding – if companies are to be given support then we consider that they would need to demonstrate the scale of the problem and that they have done all they can to fund themselves e.g. through void reduction, or reduction in bad debt.

9. Our proposals for social tariffs

The issues relating to scheme structure, whether to pool funding, and potential effects on customers funding the scheme are complex to resolve. Phased implementation needs to be considered to mitigate these effects and allow issues to be resolved.

We consider that the best way forward is to develop a limited national scheme at this stage, with potential to extend this on the basis of experience with its implementation. This would include:

- Introduction of a relatively simple scheme at national level, with clear eligibility and a simple tariff structure.
- Companies could have their own supplementary schemes, providing additional discretionary help, depending on their own circumstances.
- Any funding from a national pool should be contingent on a clear need, after a company has done all it can to generate additional revenue to fund the scheme.

The benefits from this would be that:

- It would reduce the likelihood of needing to make changes in the national scheme to reduce eligibility or adjust tariff structure, avoiding the resulting incidence effects on those benefiting from the scheme.
- It would avoid unacceptably large bill increases for those not benefiting from the national scheme, many of whom are struggling to pay.
- It would avoid the potential effects on those currently benefiting from social tariffs who could receive less or no benefit from the national scheme.
- It would ensure incentives to collect revenue and implement social tariffs efficiently are retained.